FINANCIAL ACCOUNTING STANDARDS BOARD

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Financial Instruments – Credit Losses

Measurement of Credit Losses on Financial Instruments

Transition Resource Group (TRG) Meeting

April 1, 2016

Meeting Objective: The purpose of this TRG meeting is to ensure that the measurement guidance of the expected credit loss portion of the upcoming standard (Subtopic 326-20) clearly communicates the Board's decisions.

Topic	Time
1. Introductions & Opening Remarks	8:30 – 8:45
2. TRG participants are asked to consider the following questions in relation to Subtopic 326-20:	8:45 – 10:30

a. Is it clear within Subtopic 326-20 that an entity will be able to utilize various methodologies to determine their expectation of credit losses and that the upcoming standard does not prescribe one method?

b. Is it clear within Subtopic 326-20 that an entity will not be required to forecast conditions over the entire life of a financial asset?

c. To the extent an entity reverts to historical losses in accordance with 326-20-30-9, is it clear that an entity has flexibility to determine the historical loss information to which it would revert and the method of reversion?

d. Is it clear that an entity should incorporate information in its expectations of credit losses that are relevant to the entity and accessible without undue cost or effort? Is it clear that external information should not be utilized if it is not relevant or less relevant than an entity's own internal information?

e. Example 2 in the implementation guidance demonstrates how expected credit losses would be measured for an individual loan. We understand that many performing loans will continue to be collectively assessed, possibly based on call report categories. Do TRG members find Example 2 helpful or should we remove it from the guidance?

3. Break 10:30 – 10:45

4. Other observations and comments on clarity of Subtopic 326-20 10:45– 12:00

5. Administrative matters 12:00 – 12:30

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The following paragraphs represent the FASB staff's drafting of the Board decision's on measuring expected credit losses for financial assets measured at amortized cost. The standard is not final until the Accounting Standards Update is issued and the guidance is not required until the effective date.

Addition of Topic 326

1. Add Topic 326, with a link to transition paragraph 326-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined, except for content moved from other paragraphs in the Codification.]

Financial Instruments—Credit Losses—Overall

Overview and Background

326-10-05-1 This Topic provides guidance on how an entity should measure expected credit losses on financial instruments.

326-10-05-2 This Topic includes the following Subtopics:

a. Financial Instruments—Credit Losses—Measured at Amortized Cost (Subtopic 326-20)
b. Financial Instruments—Credit Losses—Available-for-Sale Debt Securities (Subtopic 326-30)

Scope and Scope Exceptions

General

> Entities

326-10-15-1 The guidance in this Subtopic applies to all entities.

Glossary

Amortized Cost Basis

The amortized cost basis is the amount at which an investment is originated or acquired, adjusted for accretion or amortization of premium, discount, and net deferred fees or costs, collection of cash, writeoffs, foreign exchange, and fair value hedge accounting adjustments.

Effective Interest Rate

The rate of return implicit in the **financial asset**, that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the financial asset. For purchased financial assets with credit deterioration, however, to decouple interest income from credit loss recognition, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to an acquirer's assessment of credit losses at the date of acquisition.

Debt Security (first definition)

Any security representing a creditor relationship with an entity. The term debt security also includes all of the following:

a. Preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor
b. A collateralized mortgage obligation (or other instrument) that is issued in equity form but is required to be accounted for as a nonequity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position
c. U.S. Treasury securities
d. U.S. government agency securities
e. Municipal securities
f. Corporate bonds
g. Convertible debt
h. Commercial paper
i. All securitized debt instruments, such as collateralized mortgage obligations and real estate mortgage investment conduits
j. Interest-only and principal-only strips.

The term debt security excludes all of the following:

a. Option contracts
b. Financial futures contracts
c. Forward contracts
d. Lease contracts
e. Receivables that do not meet the definition of security and, so, are not debt securities (unless they have been securitized, in which case they would meet the definition of a security), for example:
    1. Trade accounts receivable arising from sales on credit by industrial or commercial entities
    2. Loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions.

Financial Asset (second definition)

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

A financial asset exists if and when two or more parties agree to payment terms and those payment terms are reduced to a contract. To be a financial asset, an asset must arise from a contractual agreement between two or more parties, not by an imposition of an obligation by one party on another.

Loan (second definition)

A contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable.

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a not-for-profit entity nor an employee benefit plan is a business entity.

a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Purchased Financial Assets with Credit Deterioration

Acquired individual financial assets (or acquired groups of financial assets with similar risk characteristics) that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment. See paragraph 326-20-55-5 for more information on the meaning of similar risk characteristics for assets measured on an amortized cost basis.

Securities and Exchange Commission (SEC) Filer

An entity that is required to file or furnish its financial statements with either of the following:

a. The Securities and Exchange Commission (SEC)
b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.

Troubled Debt Restructuring

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2016-XX, *Financial Instruments—Credit Losses (Topic 326)*

326-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-XX, *Financial Instruments—Credit Losses (Topic 326):*

a. The pending content that links to this paragraph shall be effective as follows:
    1. For **public business entities** that meet the definition of an **SEC filer**, for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years
    2. For public business entities that do not meet the definition of an SEC filer, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years
    3. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.
b. An entity shall apply the pending content that links to this paragraph by means of a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period in which the guidance is effective.
c. An entity shall apply prospectively the pending content that links to this paragraph for **purchased financial assets with credit deterioration** to **financial assets** for which Subtopic 310-30 was previously applied. The prospective application will result in an adjustment to the **amortized cost basis** of the financial asset to reflect the addition of the allowance for credit losses at the date of adoption. An entity shall not reassess whether recognized financial assets meet the criteria of a purchased financial asset with credit deterioration as of the date of adoption. An entity may elect to maintain pools of **loans** accounted for under Subtopic 310-30 at adoption. An entity shall not reassess whether modifications to individual acquired financial assets accounted for in pools are **troubled debt restructurings** as of the date of adoption. The noncredit discount or premium, after the adjustment for the allowance for credit losses, shall be accreted to interest income using the interest method based on the **effective interest rate** determined after the adjustment for credit losses at the adoption date.
d. An entity shall apply prospectively the pending content that links to this paragraph to **debt securities** for which an other-than-temporary impairment had been recognized before the date of adoption, such that the amortized cost basis (including previous write-downs) of the debt security is unchanged. In addition, the effective interest rate on a security will remain unchanged as a result of the adoption of the pending content that links to this paragraph. Amounts previously recognized in accumulated other comprehensive income as of the adoption date that relate to improvements in cash flows will continue to be accreted to interest income over the remaining life of the debt security on a level-yield basis. Recoveries of amounts previously written off relating to improvements in cash flows after the date of adoption shall be recorded in the period received.
e. Early application of the pending content that links to this paragraph is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

f. An entity shall provide the following disclosures in the period that the entity adopts the pending content that links to this paragraph:
    1. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle.
    2. The method of applying the change.
    3. The effect of the adoption on any line item in the statement of financial position, if material, as of the beginning of the first period for which the pending content that links to this paragraph is effective. Presentation of the effect on financial statement subtotals is not required.
    4. The cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the beginning of the first period for which the pending content that links to this paragraph is effective.

g. An entity that issues interim financial statements shall provide the disclosures in item (f) in each interim financial statement of the year of change and the annual financial statement of the period of the change.

Addition of Subtopic 326-20

2. Add Subtopic 326-20, with a link to transition paragraph 326-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined, except for content moved from other paragraphs in the Codification.]

Financial Instruments—Credit Losses—Measured at Amortized Cost

Overview and Background

326-20-05-1 This Subtopic provides guidance on how an entity should measure expected credit losses on financial instruments measured at amortized cost.

Scope and Scope Exceptions

General

> Entities

326-20-15-1 The guidance in this Subtopic applies to all entities.

> Instruments

326-20-15-2 The guidance in this Subtopic applies to the following **financial assets** that are not measured at **fair value**:

a. Financial assets measured at amortized cost basis, including the following:
    1. **Financing receivables**
    2. Held-to-maturity **debt securities**
    3. Receivables that result from revenue transactions within the scope of Topic 605 on revenue recognition and Topic 606 on revenue from contracts with customers
    4. **Reinsurance receivables** that result from insurance transactions within the scope of Topic 944 on insurance.

b. Net investment in leases recognized by a lessor in accordance with Topic 842 on leases

c. Off-balance-sheet credit exposures not accounted for as insurance. Off-balance-sheet credit exposure refers to credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments, except for instruments within the scope of Topic 815 on derivatives and hedging.

326-20-15-3 The guidance in this Subtopic does not apply to the following instruments:

a. **Loans** made to participants by defined contribution employee benefit plans
b. Policy loan receivables of an insurance entity
c. Promises to give (pledges receivable) of a not-for-profit entity
d. Loans and receivables between entities under common control.

Glossary

Amortized Cost Basis

The amortized cost basis is the amount at which an investment is originated or acquired, adjusted for accretion or amortization of premium, discount, and net deferred fees or costs, collection of cash, writeoffs, foreign exchange, and fair value hedge accounting adjustments.

Class of Financing Receivable

A group of financing receivables determined on the basis of both of the following:

a. Risk characteristics of the financing receivable
b. An entity's method for monitoring and assessing credit risk.

See paragraphs 326-20-55-11-through 55-14 and 326-20-50-3.

Collateral-Dependent Financial Asset

A financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral if a borrower is experiencing financial difficulty based on an entity's assessment as of the reporting date.

Credit Quality Indicator

A statistic about the credit quality of a financial asset.

Debt Security (first definition)

Any security representing a creditor relationship with an entity. The term debt security also includes all of the following:

a. Preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor
b. A collateralized mortgage obligation (or other instrument) that is issued in equity form but is required to be accounted for as a nonequity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position
c. U.S. Treasury securities
d. U.S. government agency securities
e. Municipal securities
f. Corporate bonds
g. Convertible debt
h. Commercial paper
i. All securitized debt instruments, such as collateralized mortgage obligations and real estate mortgage investment conduits
j. Interest-only and principal-only strips.

The term debt security excludes all of the following:

a. Option contracts
b. Financial futures contracts
c. Forward contracts
d. Lease contracts
e. Receivables that do not meet the definition of security and, so, are not debt securities (unless they have been securitized, in which case they would meet the definition of a security), for example:
    1. Trade accounts receivable arising from sales on credit by industrial or commercial entities
    2. Loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions.

Effective Interest Rate

The rate of return implicit in the **financial asset**, that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the financial asset. For purchased financial assets with credit deterioration, however, to decouple interest income from credit loss recognition, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to an acquirer's assessment of credit losses at the date of acquisition.

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Financial Asset (second definition)

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

A financial asset exists if and when two or more parties agree to payment terms and those payment terms are reduced to a contract. To be a financial asset, an asset must arise from a contractual agreement between two or more parties, not by an imposition of an obligation by one party on another.

Financing Receivable

A financing arrangement that has both of the following characteristics:

a. It represents a contractual right to receive money in either of the following ways:
   1. On demand
   2. On fixed or determinable dates.
b. It is recognized as an asset in the entity's statement of financial position.

See paragraphs 310-10-55-13 through 55-15 for more information on the definition of financing receivable, including a list of items that are excluded from the definition (for example, debt securities).

Freestanding Contract

A freestanding contract is entered into either:

a. Separate and apart from any of the entity's other financial instruments or equity transactions
b. In conjunction with some other transaction and is legally detachable and separately exercisable.

Line-of-Credit Arrangement

A line-of-credit or revolving-debt arrangement is an agreement that provides the borrower with the option to make multiple borrowings up to a specified maximum amount, to repay portions of previous borrowings, and to then reborrow under the same contract. Line-of-credit and revolving-debt arrangements may include both amounts drawn by the debtor (a debt instrument) and a commitment by the creditor to make additional amounts available to the debtor under predefined terms (a loan commitment).

Loan (second definition)

A contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable.

Loan Commitment

Loan commitments are legally binding commitments to extend credit to a counterparty under certain prespecified terms and conditions. They have fixed expiration dates and may either be fixed-rate or variable-rate. Loan commitments can be either of the following:

a. Revolving (in which the amount of the overall commitment is reestablished upon repayment of previously drawn amounts)
b. Nonrevolving (in which the amount of the overall commitment is not reestablished upon repayment of previously drawn amounts).

Loan commitments can be distributed through syndication arrangements, in which one entity acts as a lead and an agent on behalf of other entities that will each extend credit to a single borrower. Loan commitments generally permit the lender to terminate the arrangement under the terms of covenants negotiated under the agreement. This is not an authoritative or all-encompassing definition.

Portfolio Segment

The level at which an entity develops and documents a systematic methodology to determine its allowance for credit losses. See paragraphs 326-20-55-10 and 326-20-50-3.

Purchased Financial Assets with Credit Deterioration

Acquired individual financial assets (or acquired groups of financial assets with similar risk characteristics) that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment. See paragraph 326-20-55-5 for more information on the meaning of similar risk characteristics for assets measured on an amortized cost basis.

Reinsurance Receivable

All amounts recoverable from reinsurers for paid and unpaid claims and claim settlement expenses, including estimated amounts receivable for unsettled claims, claims incurred but not reported, or policy benefits.

Standby Letter of Credit

A letter of credit (or similar arrangement however named or designated) that represents an obligation to the beneficiary on the part of the issuer for any of the following:

a. To repay money borrowed by or advanced to or for the account of the account party
b. To make payment on account of any evidence of indebtedness undertaken by the account party
c. To make payment on account of any default by the account party in the performance of an obligation.

A standby letter of credit would not include the following:

a. Commercial letters of credit and similar instruments where the issuing bank expects the beneficiary to draw upon the issuer and which do not guarantee payment of a money obligation
b. A guarantee or similar obligation issued by a foreign branch in accordance with and subject to the limitations of Regulation M of the Federal Reserve Board.

Troubled Debt Restructuring

A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.

Initial Measurement

General

> Developing an Estimate of Expected Credit Losses

326-20-30-1 The allowance for credit losses is a valuation account that is deducted from the **amortized cost basis** of the **financial asset(s)** to present the net amount expected to be collected on the financial asset. At the reporting date, an entity shall record an allowance for credit losses on financial assets within the scope of this Subtopic. An entity shall report in net income (as a credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s).

326-20-30-2 An entity shall measure expected credit losses of financial assets on a collective (pool) basis when similar risk characteristic(s) exist (as described in paragraph 326-20-55-5). If an entity determines that a financial asset does not share risk characteristics with its other financial assets, the entity shall evaluate the financial asset for expected credit losses on an individual basis. If a financial asset is evaluated on an individual basis, an entity should not also include it in a collective evaluation. That is, financial assets should not be included in both collective assessments and individual assessments.

326-20-30-3 The allowance for credit losses may be determined using various methods. For example, an entity may use discounted cash flow methods, loss rate methods, roll-rate methods, probability-of-default methods, or methods that utilize an aging schedule. An entity is not required to utilize a discounted cash flow method to estimate expected credit losses. Similarly, an entity is not required to reconcile the estimation technique it uses with a discounted cash flow method.

326-20-30-4 If an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's **effective interest rate**. When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the **amortized cost basis** and the present value of the expected cash flows.

326-20-30-5 If an entity estimates expected credit losses using a method other than a discounted cash flow method in paragraph 326-20-30-4, the allowance for credit losses shall reflect the entity's expected credit losses of the amortized cost basis of the financial asset(s) as of the reporting date. An entity may develop its estimate by separately measuring the following components of the amortized cost basis, including both of the following:

a. Amortized cost basis, excluding premiums, discounts (including net deferred fees and costs), foreign exchange, and fair value hedge accounting adjustments
b. Premiums or discounts, including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments.

326-20-30-6 An entity shall estimate expected credit losses over the contractual term of the financial asset(s) when using the methods in accordance with paragraph 326-20-30-5. An entity shall consider prepayments either as a separate input in the method or they may be embedded in the credit loss experience in accordance with paragraph 326-20-30-5. An entity shall consider estimated prepayments in the future principal and interest cash flows when a method in accordance with paragraph 326-20-30-4 is utilized. An entity shall not extend the contractual term for expected extensions, renewals, and modifications unless it has a reasonable expectation at the reporting date that it will execute a **troubled debt restructuring** with the borrower.

326-20-30-7 An entity shall consider available information relevant to assessing the collectibility of cash flows, including information about past events, current conditions, and reasonable and supportable forecasts, when developing an estimate of expected credit losses on financial asset(s). An entity shall consider relevant qualitative and quantitative factors that may be based on internal information or external information and relate to the environment in which the entity operates and are specific to the borrower(s). When developing an estimate of expected credit losses on collectively or individually evaluated financial assets, an entity shall consider available relevant internal information and external information, such as credit ratings, credit scores, and credit loss information for financial assets of similar credit quality. When financial assets are evaluated on a collective or individual basis, an entity is not required to search all possible information that is not reasonably available without undue cost and effort. Furthermore, an entity is not required to develop a hypothetical pool of financial assets. An entity may find that its internal information about collectibility may be more relevant to the similar risk characteristics of its financial assets than external information.

326-20-30-8 Historical credit loss experience of financial assets with similar risk characteristics generally provides a basis for an entity's assessment of expected credit losses. However, an entity shall not rely solely on past events to estimate expected credit losses. When an entity uses historical loss experience, it shall consider the need to adjust historical experience for the conditions that existed for the period over which historical experience was evaluated and how those conditions differ from what management currently expects based on current conditions and reasonable and supportable forecasts. The adjustments to historical loss experience may be qualitative in nature and should reflect changes related to relevant data (such as changes in unemployment rates, property values, commodity values, payment status, underwriting standards, or other factors that are associated with credit losses on the financial asset or in the group of financial assets).

326-20-30-9 An entity shall also incorporate reasonable and supportable forecasts in its estimate of expected credit losses. Some entities may be able to develop reasonable and supportable forecasts over the contractual term of the financial assets. However, an entity is not required to develop forecasts over the contractual term of the financial assets if those forecasts are not supportable. Rather, for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses, the entity shall revert to historical loss information. Historical loss information can be internal or external historical loss information (or a combination of both) and shall reflect the historical loss information over an economic cycle. An entity may adjust historical loss information for supportable conditions specific to a borrower (or group of borrowers) existing at the balance sheet date, not economic conditions, including (but not limited to) differences in underwriting standards or adjustments needed when historical loss information is incomplete. An entity may revert to historical loss information at the input level or based on the entire estimate. When reversion is necessary, a straight-line reversion is one acceptable reversion technique.

326-20-30-10 An entity's estimate of expected credit losses shall include a measure of the expected risk of credit loss even if that risk is remote, regardless of the method applied to estimate credit losses. However, an entity is not required to measure expected credit losses on a financial asset (or group of financial assets) in which historical credit loss experience adjusted for current conditions and reasonable and supportable forecasts results in an expectation that nonpayment of the amortized cost basis is zero. Except for the circumstances described in paragraphs 326-20-35-4 through 35-5, an entity shall not expect nonpayment of the amortized cost basis to be zero solely on the basis of the current value of collateral securing the financial asset(s) but, instead, also shall consider the nature of the collateral, potential future changes in collateral values, and historical loss experience for financial assets secured with similar collateral.

> > Off-Balance-Sheet Credit Exposures

326-20-30-11 In estimating expected credit losses for off-balance-sheet credit exposures, an entity shall estimate expected credit losses on the basis of the guidance in this Subtopic over the contractual period in which the entity is exposed to credit risk via a present contractual obligation to extend credit, unless unconditionally cancellable by the issuer. For that period of exposure, the estimate of expected credit losses should consider both the likelihood that funding will occur (which may be affected by, for example, a material adverse change clause) and an estimate of expected credit losses on commitments expected to be funded over its estimated life.

> > Credit Enhancements

326-20-30-12 The estimate of expected credit losses shall reflect how credit enhancements (other than those that are **freestanding contracts**) mitigate expected credit losses on **financial assets**, including consideration of the financial condition of the guarantor, the willingness of the guarantor to pay, and/or whether any subordinated interests are expected to be capable of absorbing credit losses on any underlying financial assets. However, when estimating expected credit losses, an entity shall not combine a financial asset with a separate freestanding contract that serves to mitigate credit loss. As a result, the estimate of expected credit losses on a financial asset (or group of financial assets) shall not be offset by a freestanding contract (for example, a purchased credit-default swap) that may mitigate expected credit losses on the financial asset (or group of financial assets).

> Purchased Financial Assets with Credit Deterioration

326-20-30-13 An entity shall record the allowance for credit losses for **purchased financial assets with credit deterioration** over the remaining contractual term of the **financial asset(s)**, in accordance with paragraphs 326-20-30-2 through 30-10 and 326-20-30-12. An entity shall add the allowance for credit losses at the date of acquisition to the purchase price to determine the initial **amortized cost basis** for purchased financial assets with credit deterioration. Any noncredit discount or premium resulting from acquiring a pool of purchased financial assets with credit deterioration shall be allocated to each individual asset.

326-20-30-14 If an entity estimates expected credit losses using a discounted cash flow method, the entity shall discount expected credit losses at the rate that equates the present value of the purchaser's estimate of the asset's future cash flows with the purchase price of the asset. If an entity estimates expected credit losses using a method other than a discounted cash flow method, the entity shall estimate expected credit losses based on the unpaid principal balance (face value) of the **financial asset(s)**. Paragraphs 326-20-55-66 through 55-78 contain examples and implementation guidance.

326-20-30-15 An entity shall account for purchased financial assets that do not have a more-than-insignificant deterioration in credit quality since origination in a manner consistent with originated financial assets, in accordance with paragraphs 326-20-30-1 through 30-10 and 326-20-30-12. An entity shall not apply 326-20-30-13 through 30-14 for purchased financial assets that do not have a more than insignificant deterioration in credit quality since origination.

Subsequent Measurement

General

> Reporting Changes in Expected Credit Losses

326-20-35-1 At each reporting date, an entity shall record an allowance for credit losses on **financial assets** within the scope of this Subtopic. An entity shall compare its current estimate of expected credit losses with the estimate of expected credit losses previously recorded. An entity shall report in net income (as a credit loss expense or a reversal of credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s). An entity shall report in net income any changes in the allowance for credit losses that relate to **purchased financial assets with credit deterioration** (as credit loss expense or reversal of credit loss expense). The method applied to initially measure expected credit losses for the assets included in paragraph 326-20-30-14 also shall be applied consistently over time and aim to faithfully estimate expected credit losses for financial asset(s) by applying the principles in this Subtopic.

326-20-35-2 An entity shall evaluate whether a financial asset in a pool continues to exhibit similar characteristics with other financial assets in the pool. For example, there may be changes in credit risk, borrower circumstances, recognition of writeoffs, or cash collections that have been fully applied to principal on the basis of nonaccrual practices that may require a reevaluation to determine if the asset has migrated to have similar characteristics with assets in another pool, or if the credit loss measurement of the asset should be performed individually because the asset no longer has similar risk characteristics.

326-20-35-3 An entity shall adjust at each reporting period its estimate of expected credit losses on off-balance-sheet credit exposures. An entity shall report in net income (as credit loss expense or a reversal of credit loss expense) the amount necessary to adjust the liability for credit losses for management's current estimate of expected credit losses on off-balance-sheet credit exposures at each reporting date.

> Practical Expedients for Certain Financial Assets Secured by Collateral

> > Collateral Dependent Financial Assets

326-20-35-4 An entity may, as a practical expedient, use the **{add glossary link to 2nd definition}fair value{add glossary link to 2nd definition)** of the collateral at the reporting date when developing its estimate of the allowance for credit losses for a **financial asset** for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date (**collateral-dependent financial asset**). If an entity uses the practical expedient on a collateral-dependent financial asset and repayment or satisfaction of the asset depends on the sale of the collateral, the fair value of the collateral shall be adjusted for estimated costs to sell (on a discounted basis). However, the entity shall not incorporate its estimated costs to sell the collateral if repayment or satisfaction of the financial asset depends only on the operation, rather than on the sale, of the collateral. For a collateral-dependent financial asset, an entity may expect credit losses of zero when the fair value (less costs to sell, if applicable) of the collateral at the reporting date is equal to or exceeds the **amortized cost basis** of the financial asset. If the fair value of the collateral is less than the amortized cost basis of the financial asset for which the practical expedient has been elected, an entity shall recognize an allowance for credit losses on the collateral-dependent financial asset, which is measured as the difference between the fair value of the collateral, less costs to sell (if applicable), at the reporting date and the amortized cost basis of the financial asset.

> > Financial Assets Secured by Collateral Maintenance Provisions

326-20-35-5 For certain **financial assets**, the borrower may be required to continually adjust the amount of the collateral securing the financial asset(s) as a result of **fair value** changes in the collateral. In those situations, an entity may use, as a practical expedient, a method that compares the **amortized cost basis** with the fair value of collateral at the reporting date to measure the estimate of expected credit losses. An entity may determine that the expectation of nonpayment of the amortized cost basis is zero if the borrower continually replenishes the collateral securing the financial asset such that the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset. If the fair value of the collateral at the reporting date is less than the amortized cost basis of the financial asset, an entity shall limit the measurement of the allowance for credit losses on the financial asset to the difference between the fair value of the collateral at the reporting date and the amortized cost basis of the financial asset.

> Loans Subsequently Identified for Sale

326-20-35-6 Once a decision has been made to sell **loans** not currently classified as held-for-sale, those loans shall be transferred into the held-for-sale classification. The application of the write-off guidance in paragraph 326-20-35-7 may result in a portion of the amortized cost basis being written off before the loan has been transferred to the held-for-sale classification. Upon transfer, an entity shall measure a valuation allowance equal to the amount by which the **amortized cost basis** (which is net of any previous write-offs but not the allowance for credit losses) exceeds the fair value. This paragraph applies to both mortgage and nonmortgage loans.

> Writeoffs and Recoveries of Financial Assets

326-20-35-7 ~~Credit losses for loans and trade receivables~~ Writeoffs of **financial assets**, which may be ~~for all or part of a particular loan or trade receivable~~ a full or partial writeoff, shall be deducted from the allowance. The ~~related loan or trade receivable balance~~ writeoff shall be ~~charged off~~ recorded in the period in which the ~~loans or trade receivables~~ financial asset(s) are deemed uncollectible. Recoveries of financial assets and trade receivables previously ~~charged~~ written off shall be recorded when received. **[Content amended as shown and moved from paragraph 310-10-35-41]**

326-20-35-8 Practices differ between entities as some industries typically credit recoveries directly to earnings while financial institutions typically credit the allowance for ~~loan~~ credit losses for recoveries. The combination of this practice and the practice of frequently reviewing the appropriateness ~~adequacy~~ of the allowance for ~~loan~~ credit losses results in the same credit to earnings in an indirect manner. **[Content amended as shown and moved from paragraph 310-10-35-42]**

> Interest Income on Purchased Financial Assets with Credit Deterioration

326-20-35-9 This Subtopic does not address how a creditor shall recognize interest income. See paragraphs 310-10-35-54 through 35-56 for guidance on recognition of interest income on **purchased financial assets with credit deterioration**. See paragraph 326-20-45-3 for presentation guidance.

Other Presentation Matters

General

326-20-45-1 For **financial assets** measured at amortized cost within the scope of this Subtopic, an entity shall separately present on the statement of financial position, the allowance for credit losses that is deducted from the asset's **amortized cost basis**.

326-20-45-2 For off-balance-sheet credit exposures within the scope of this Subtopic, an entity shall present the estimate of expected credit losses on the statement of financial position as a liability. Credit losses for off-balance-sheet financial instruments shall be deducted from the liability for credit losses in the period in which the off-balance-sheet financial instruments expire, result in the recognition of a **financial asset**, or are otherwise ~~liability is~~ settled. An ~~accrual for~~ estimate of expected credit losses on a financial instrument with off-balance-sheet risk shall be recorded separate from ~~a valuation account~~ the allowance for credit losses related to a recognized financial instrument. **[Content amended as shown and moved from paragraphs 825-10-35-1 through 35-2]**

326-20-45-3 When a discounted cash flow approach is used to estimate expected credit losses, the change in present value from one reporting period to the next may result not only from the passage of time but also from changes in estimates of the timing or amount of expected future cash flows. An entity that measures credit losses based on a discounted cash flow approach is permitted to report the entire change in present value as credit loss expense (or reversal of credit loss expense). Alternatively, an entity may report the change in present value attributable to the passage of time as interest income. See paragraph 326-20-50-12 for a disclosure requirement applicable to entities that choose the latter alternative and report changes in present value attributable to the passage of time as interest income.

326-20-45-4 ~~The observable market price of an impaired **loan** or the~~ The **fair value** of the collateral of ~~an impaired **collateral-dependent loan**~~ a **collateral-dependent financial asset** may change from one reporting period to the next. Changes in ~~observable market prices or~~ the **{add glossary link to 2nd definition}**fair value**{add glossary link to 2nd definition}** of the collateral shall be reported as ~~bad-debt~~ credit loss expense or a ~~reduction in bad-debt~~ reversal of credit loss expense when the guidance in paragraphs 326-20-35-4 through 35-5 is applied. [**Content amended as shown and moved from paragraph 310-10-45-6]**

Disclosure

General

326-20-50-1 For instruments within the scope of this Subtopic, this Section provides the following disclosure guidance on credit risk and the measurement of expected credit losses:

a. **Credit quality information**
b. Allowance for credit losses
c. Past-due status
d. Nonaccrual status
e. **Purchased financial assets with credit deterioration**
f. **Collateral-dependent financial assets**.

326-20-50-2 The disclosure guidance in this Section should enable a user of the financial statements to understand the following:

a. The credit risk inherent in a portfolio and how management monitors the credit quality of the portfolio
b. Management's estimate of expected credit losses
c. Changes in the estimate of expected credit losses that have taken place during the period.

326-20-50-3 For **financing receivables** and net investment in leases, the disclosures guidance in this Subtopic requires an entity to provide information by either **portfolio segment** or **class of financing receivable**. For held-to-maturity **debt securities**, the disclosure guidance in this Subtopic requires an entity to provide information by major security type. Paragraphs 326-20-55-10 through 55-14 provide implementation guidance about the terms *portfolio segment* and *class of financing receivable.* When disclosing information, an entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements in this Section. An entity must strike a balance between not obscuring important information as a result of too much aggregation and not overburdening financial statements with excessive detail that may not assist a financial statement user in understanding the entity's financial assets and allowance for credit losses. For example, an entity should not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity should not disclose information that is so aggregated that it obscures important differences between the different types of **financial assets** and associated risks.

> Credit Quality Information

326-20-50-4 An entity shall provide information that enables a financial statement user to do both of the following:

a. Understand how management monitors the credit quality of its **financial assets**
b. Assess the quantitative and qualitative risks arising from the credit quality of its financial assets.

326-20-50-5 To meet the objectives in paragraph 326-20-50-4, an entity shall provide quantitative and qualitative information by **class of financing receivable** and major security type about the credit quality of financial assets within the scope of this Subtopic (excluding off-balance-sheet commitments), including all of the following:

a. A description of the **credit quality indicator(s)**
b. The **amortized cost basis**, by credit quality indicator
c. For each credit quality indicator, the date or range of dates in which the information was last updated for that credit quality indicator.

326-20-50-6 When disclosing credit quality indicators of financing receivables and net investment in leases (except for **reinsurance receivables** and funded or unfunded amounts of **line-of-credit arrangements**, such as credit cards), an entity shall present the **amortized cost basis** within each credit quality indicator by year of origination (that is, vintage year). For purchased financing receivables and net investment in leases an entity shall use the initial date of issuance to determine the year of origination, not the date of acquisition. An entity need not present more than the most recent five origination years and, if those years are not presented separately, shall present the amortized cost basis for financing receivables originated before the fifth annual reporting period in the aggregate. For interim-period disclosures, the current year-to-date originations in the current reporting period are considered to be the current-period originations.

326-20-50-7 An entity shall use the guidance in paragraphs 310-20-35-9 through 35-12 when determining whether a modification, extension, or renewal of a financing receivable should be presented as a current-period origination. An entity shall use the guidance in paragraphs 842-10-25-8 through 25-9 when determining whether a lease modification should be presented as a current-period origination.

326-20-50-8 If an entity discloses internal-risk ratings, then the entity shall provide qualitative information on how those internal-risk ratings relate to the likelihood of loss. **[Content moved from paragraph 310-10-50-30]**

326-20-50-9 The requirements to disclose credit quality indicators in paragraphs 326-20-50-4 through 50-5 do not apply to receivables measured at lower of amortized cost or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

> Allowance for Credit Losses

326-20-50-10 An entity shall provide information that enables a financial statement user to do the following:

a. Understand management's method for developing its allowance for credit losses
b. Understand the information that management used in developing its current estimate of expected credit losses
c. Understand the economic circumstances that caused changes to the allowance for credit losses, thereby affecting the related credit loss expense (or reversal) reported for the period.

326-20-50-11 To meet the objectives in paragraph 326-20-50-10, an entity shall disclose all of the following by **portfolio segment** and major security type:

a. A description of how expected loss estimates are developed.
b. A description of the entity's accounting policies and methodology to estimate the allowance for credit losses, as well as a discussion of the factors that influenced management's current estimate of expected credit losses, including:
    1. Past events
    2. Current conditions
    3. Reasonable and supportable forecasts about the future.
c. A discussion of risk characteristics relevant to each portfolio segment
d. A discussion of the changes in the factors that influenced management's current estimate of expected credit losses and the reasons for those changes (for example, changes in portfolio composition, underwriting practices, and significant events or conditions that affect the current estimate but were not contemplated or relevant during a previous period).
e. Identification of changes to the entity's accounting policies in accordance with Subtopic 250-10 on accounting changes and error corrections, changes to the methodology from the prior period, and its rationale for those changes.
f. Reasons for significant changes in the amount of writeoffs, if applicable.
g. A discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period.
h. The amount of any significant purchases of **financial assets** during each reporting period.
i. The amount of any significant sales of financial assets or reclassifications of **{add glossary link to 2nd definition)loans{add glossary link to 2nd definition}** to held for sale during each reporting period

326-20-50-12 ~~Paragraphs 310-10-45-5 through 45-6~~ Paragraph 326-20-45-3 explains that a creditor that measures ~~impairment~~ expected credit losses based on ~~the present value of future expected cash flows~~ a discounted cash flow approach is permitted to report the entire change in present value as ~~bad-debt~~ credit loss expense (or reversal of credit loss expense) but may also report the change in present value attributable to the passage of time as interest income. Creditors that choose the latter alternative shall disclose the amount ~~of~~ recorded to interest income that represents the change in present value attributable to the passage of time. **[Content amended as shown and moved from paragraph 310-10-50-19]**

> > Rollforward of the Allowance for Credit Losses

326-20-50-13 Furthermore, to enable a financial statement user to understand the activity in the allowance for credit losses for each period, an entity shall separately provide by **portfolio segment** and major security type the quantitative disclosures of the activity in the allowance for credit losses for **financial assets** within the scope of this Subtopic, including all of the following:

a. The beginning balance in the allowance for credit losses
b. Current-period provision for expected credit losses
c. The initial allowance for credit losses recognized on **purchased financial assets with credit deterioration**, if applicable
d. Writeoffs charged against the allowance
e. Recoveries of amounts previously written off, if applicable
f. The ending balance in the allowance for credit losses.

> Past-Due Status

326-20-50-14 To enable a financial statement user to understand the extent of **financial assets** that are past due, an entity shall provide an aging analysis of the **amortized cost basis** for financial assets that are past due as of the reporting date, disaggregated by **class of financing receivable** and major security type. An entity also shall disclose when it considers a financial asset to be past due.

326-20-50-15 The requirements to disclose past-due status in paragraph 326-20-50-14 does not apply to receivables measured at lower of amortized cost or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

> > Nonaccrual Status

326-20-50-16 To enable a financial statement user to understand the credit risk and interest income recognized on **financial assets** on nonaccrual status, an entity shall disclose all of the following, disaggregated by class of **financing receivable** and major security type:

a. The **amortized cost basis** of financial assets on nonaccrual status as of the beginning of the reporting period and the end of the reporting period
b. The amount of interest income recognized during the period on nonaccrual financial assets
c. The amortized cost basis of financial assets that are 90 days or more past due, but are not on nonaccrual status as of the reporting date
d. The amortized cost basis of financial assets on nonaccrual status for which there are no related allowance for credit losses as of the reporting date.

326-20-50-17 An entity's summary of significant accounting policies for financial assets within the scope of this Subtopic shall include all of the following:

a. Nonaccrual policies, including the policies for discontinuing accrual of interest, recording payments received on nonaccrual assets (including the cost recovery method, cash basis method, or some combination of those methods), and resuming accrual of interest, if applicable
b. The policy for determining past-due or delinquency status
c. The policy for recognizing writeoffs within the allowance for credit losses

326-20-50-18 The requirements to disclose nonaccrual status in paragraphs 326-20-50-16 and 50-17 do not apply to receivables measured at lower of amortized cost or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

> Purchased Financial Assets with Credit Deterioration

326-20-50-19 To the extent an entity **purchased financial assets with credit deterioration** during the current reporting period, an entity shall provide a reconciliation of the difference between the purchase price of the **financial assets** and the par value of the assets, including:

a. The purchase price
b. The allowance for credit losses at the acquisition date based on the acquirer's assessment
c. The discount (or premium) attributable to other factors
d. The par value.

> Collateral-Dependent Financial Assets

326-20-50-20 For a **financial asset** for which the repayment (on the basis of an entity's assessment as of the reporting date) is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty, an entity shall describe the type of collateral by **class of financing receivable** and major security type. The entity also shall qualitatively describe the extent to which collateral secures its financial assets.

326-20-50-21 For a financial asset for which the repayment (on the basis of an entity's assessment as of the reporting date) is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty, the entity shall qualitatively explain, by class of financing receivable and major security type, significant changes in the extent to which the collateral secures the entity's financial assets, whether because of a general deterioration or some other reason.

> Off-Balance-Sheet Credit Exposures

326-20-50-22 In addition to disclosures required by other Topics ~~Subtopic 450-20~~, an entity shall disclose a description of the accounting policies and methodology the entity used to estimate its liability for off-balance-sheet credit exposures and related charges for those credit exposures. Such a description shall identify the factors that influenced management's judgment (for example, historical losses, ~~losses and~~ existing economic conditions, and reasonable and supportable forecasts) and a discussion of risk elements relevant to particular categories of financial instruments. **[Content amended as shown and moved from paragraph 310-10-50-9]**

326-20-50-23 Off-balance-sheet credit exposures refers to credit exposures on off-balance-sheet **{add glossary link}**loan commitments**{add glossary link}**, **{remove glossary link}standby letters of credit{remove glossary link}**, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815. **[Content amended as shown and moved from paragraph 310-10-50-10]**

Implementation Guidance and Illustrations

> Implementation Guidance

326-20-55-1 This Section provides implementation guidance for management's estimate of expected credit losses on **financial asset(s)**. This Section is organized as follows:

a. Information considered when estimating expected credit losses
b. Developing an estimate of expected credit losses
c. Net Investment in leases
d. Effect of a fair value hedge on the discount rate when using a discounted cash flow model.

> > Information Considered When Estimating Expected Credit Losses

326-20-55-2 In determining its estimate of expected credit losses, an entity shall evaluate information related to the borrower's creditworthiness, the issuer's underwriting practices, and the current and forecasted direction of the economic environment. This Subtopic does not specify a particular methodology to be applied by an entity for determining historical credit loss experience. That methodology may vary depending on the size of the entity, the range of the entity's activities, the nature of the entity's **financial assets**, and other factors.

326-20-55-3 Historical loss information generally provides a basis for an entity's assessment of expected credit losses. An entity may use historical periods that represent management's expectations for future credit losses. An entity may also elect to use other historical loss periods, adjusted for current conditions, and other reasonable and supportable forecasts. When determining historical loss information in estimating expected credit losses, it is important that the information about historical credit loss data, after adjustments for current conditions and reasonable and supportable forecasts, is applied to pools that are defined in a manner that is consistent with the pools for which the historical credit loss experience was observed.

326-20-55-4 Because historical experience may not fully reflect an entity's expectations about the future, management shall adjust historical loss experience, as necessary, to reflect the current conditions and reasonable and supportable forecasts not already reflected in the historical loss experience. In making this determination, management should consider characteristics of the financial assets that are practical and relevant in the circumstances. To adjust historical credit loss experience for current conditions and reasonable and supportable forecasts, an entity shall consider significant factors that are relevant to determining the expected collectibility. Examples of factors an entity may consider include any of the following, depending on the nature of the asset (not all of these may be relevant to every situation, and other factors not on the list may be relevant):

a. The borrower's financial condition, credit rating, credit score, asset quality, or business prospects
b. The borrower's ability to make scheduled interest or principal payments
c. The remaining payment terms of the financial asset(s)
d. The remaining time to maturity and the timing and extent of prepayments on the financial asset(s)
e. The nature and volume of the entity's financial asset(s)
f. The volume and severity of past due financial asset(s) and the volume and severity of adversely classified or rated financial asset(s)
g. The value of underlying collateral on financial assets in which the collateral-dependent practical expedient has not been utilized
h. The entity's lending policies and procedures, including changes in underwriting standards, collection, writeoff, and recovery practices, as well as knowledge of the borrower's operations or the borrower's standing in the community
i. The quality of the entity's credit review system
j. The experience, ability, and depth of the entity's management, lending staff, and other relevant staff
k. The environmental factors of a borrower and the areas in which the entity's credit is concentrated, such as:
    1. Regulatory, legal, or technological environment to which the entity has exposure
    2. Changes and expected changes in the general market condition of either the geographical area or the industry to which the entity has exposure
    3. Changes and expected changes in international, national, regional, and local economic and business conditions and developments in which the entity operates, including the condition and expected condition of various market segments.

> > Developing an Estimate of Expected Credit Losses

326-20-55-5 In evaluating **financial assets** on a collective (pool) basis, an entity shall aggregate financial assets on the basis of similar risk characteristics, which may include any one or a combination of the following, consistent with its policies on how it evaluates the credit risk characteristics of **financing receivables**, held-to-maturity **debt securities**, or off-balance-sheet credit exposures:

a. Internal or external (third-party) credit score or credit ratings, including the effects of differences in underwriting standards
b. Risk ratings or classification
c. Financial asset type, if applicable
d. Collateral type
e. Size
f. Effective interest rate
g. Term
h. Geographical location
i. Industry of the borrower
j. Vintage
k. Historical or expected credit loss patterns
l. Reasonable and supportable forecast periods

326-20-55-6 Estimating expected credit losses is highly judgmental and generally will require an entity to make specific judgments. Those judgments may include any of the following:

a. The definition of default for default-based statistics.
b. The approach to measuring the historical loss amount for loss-rate statistics, including whether the amount is simply based on the amortized cost amount written off and whether there should be adjustments to historical credit losses (if any) to reflect the entity's policies for recognizing accrued interest.
c. The approach to determine the appropriate historical period for estimating expected credit loss statistics.
d. The approach to adjusting historical credit loss experience to reflect current conditions and reasonable and supportable forecasts that are different from conditions existing in the historical period.
e. The methods of utilizing historical experience.
f. The method of adjusting loss statistics for recoveries.
g. How expected prepayments affect the estimate of expected credit losses.
h. How the entity plans to revert to historical credit loss experience for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses.
i. The assessment of whether a financial asset exhibits risk characteristics similar to other financial assets.

326-20-55-7 Because of the subjective nature of the estimate, this Subtopic does not require specific approaches when developing the estimate of expected credit losses. Rather, an entity should use judgment to develop estimation techniques that are applied consistently over time and aim to faithfully estimate the collectibility of the financial assets by applying the principles in this Subtopic. An entity should utilize estimation technique or techniques that are practical and relevant to the circumstance. The method(s) used to estimate expected credit losses may vary on the basis of the type of financial asset, the entity's ability to predict the timing of cash flows, and the information available to the entity.

> > Net Investment in Leases

326-20-55-8 This Subtopic requires that an entity recognize an allowance for credit losses on net investment in leases recognized by a lessor in accordance with Topic 842 on leases. When measuring expected credit losses on net investment in leases using a discounted cash flow method, the discount rate used in measuring the lease receivable under Topic 842 should be used in place of the **effective interest rate**.

> > Effect of a Fair Value Hedge on the Discount Rate When Using a Discounted Cash Flow Model

326-20-55-9 Section 815-25-35 implicitly affects the measurement of credit losses ~~impairment~~ under this Topic by requiring the present value of expected future cash flows to be discounted by the new **{add glossary link}**effective interest rate**{add glossary link}** based on the adjusted **amortized cost basis** ~~recorded investment~~ in a hedged **{add glossary link}**loan**{add glossary link}**. When the amortized cost basis ~~recorded investment~~ of a loan has been adjusted under fair value hedge accounting, the effective interest rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis ~~recorded investment~~. The adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under Section 815-25-35 shall be considered to be an adjustment of the loan's amortized cost basis ~~recorded investment~~. Paragraph 815-25-35-11 explains that the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. **[Content amended as shown and moved from paragraph 310-10-35-31]**

> > Disclosure—Application of the Term *Portfolio Segment*

326-20-55-10 This implementation guidance addresses the meaning of the term *portfolio segment*. All of the following are examples of portfolio segments:

a. Type of financing receivable
b. Industry sector of the borrower
c. Risk rate(s).

[Content moved from paragraph 310-10-55-21]

> > Disclosure—Application of the Term *Class of Financing Receivable*

326-20-55-11 This implementation guidance addresses application of the term **class of financing receivable**. An entity should base its principal determination of class of financing receivable by disaggregating to the level that the entity uses when assessing and monitoring the risk and performance of the portfolio for various types of financing receivables. In its assessment, the entity should consider the risk characteristics of the financing receivables.

326-20-55-12 In determining the appropriate level of its internal reporting to use as a basis for disclosure, an entity should consider the level of detail needed by a user to understand the risks inherent in the entity's financing receivables. An entity could further disaggregate its financing receivables portfolio by considering numerous factors. Examples of factors that the entity should consider include any of the following:

a. Categorization of borrowers, such as any of the following:
   1. Commercial **{add glossary link}**loan**{add glossary link}** borrowers
   2. Consumer loan borrowers
   3. **Related party** borrowers.
b. Type of financing receivable, such as any of the following:
   1. Mortgage loans
   2. Credit card loans
   3. Interest-only loans
   4. Finance leases.
c. Industry sector, such as either of the following:
   1. Real estate
   2. Mining.
d. Type of collateral, such as any of the following:
   1. Residential property
   2. Commercial property
   3. Government-guaranteed collateral
   4. Uncollateralized (unsecured) financing receivables.
e. Geographic distribution, including both of the following:
   1. Domestic
   2. International.

[Content moved from paragraph 310-10-55-17]

326-20-55-13 An entity also may consider factors related to concentrations of credit risk as discussed in Section 825-10-55. **[Content moved from paragraph 310-10-55-17]**

326-20-55-14 Classes of financing receivables generally are a disaggregation of a **portfolio segment**. For determining the appropriate classes of financing receivables that are related to a portfolio segment, the portfolio segment is the starting point with further disaggregation in accordance with the guidance in paragraphs 326-20-55-11~~310-10-55-16~~ through 55-13~~55-17~~. The determination of class for financing receivables that are not related to a portfolio segment (because there is no associated allowance) also should be based on the guidance in those paragraphs. **[Content amended as shown and moved from paragraph 310-10-55-18]**

> > Disclosure—Application of the Term *Credit Quality Indicator*

326-20-55-15 This implementation guidance addresses application of the term **credit quality indicator**. Examples of credit quality indicators include all of the following:

a. Consumer credit risk scores
b. Credit-rating-agency ratings
c. An entity's internal credit risk grades
d. Debt-to-value ~~Loan-to-value~~ ratios
e. Collateral
f. Collection experience
g. Other internal metrics.

[Content moved from paragraph 310-10-55-19]

326-20-55-16 An entity should use judgment in determining the appropriate credit quality indicator for each **{add glossary link}**class of financing receivable**{add glossary link}** ~~receivables~~ and major security type. As of the balance sheet date, the entity should use the most current information it has obtained for each credit quality indicator. **[Content amended as shown and moved from paragraph 310-10-55-20]**

> Illustrations

326-20-55-17 The following Examples illustrate certain initial and subsequent measurement guidance in this Subtopic to account for credit losses on **financial assets**:

a. Example 1: Estimating expected credit losses using a loss-rate approach (collective evaluation)
b. Example 2: Estimating expected credit losses using a loss-rate approach (individual evaluation)
c. Example 3: Estimating expected credit losses on a vintage-year basis
d. Example 4: Estimating expected credit losses using both a collective method and an individual asset method
e. Example 5: Estimating expected credit losses for trade receivables using an aging schedule
f. Example 6: Estimating expected credit losses—practical expedient for **collateral-dependent financial assets**
g. Example 7: Estimating expected credit losses—practical expedient for financial assets with collateral maintenance provisions
h. Example 8: Estimating expected credit losses on a U.S. Treasury security when potential default is greater than zero, but expected nonpayment is zero
i. Example 9: Recognizing writeoffs and recoveries
j. Example 10: Applying expected credit losses to unconditionally cancellable **loan commitments**
k. Example 11: Identifying **purchased financial assets with credit deterioration**
l. Example 12: Recognizing purchased financial assets with credit deterioration
m. Example 13: Determining the loss-rate approach for determining expected credit losses and the **effective interest rate** on a purchased financial assets with credit deterioration
n. Example 14: Determining the discounted cash flow approach for expected credit losses and the effective interest rate on purchased financial assets with credit deterioration
o. Example 15: Disclosing credit quality disclosures of **financing receivables**
p. Example 16: Disclosing past-due status
q. Example 17: Identifying similar risk characteristics in **reinsurance receivables**.

> > Example 1: Estimating Expected Credit Losses Using a Loss-Rate Approach (Collective Evaluation)

326-20-55-18 This Example illustrates one way an entity may estimate expected credit losses on a portfolio of **loans** with similar risk characteristics using a loss-rate approach.

326-20-55-19 Community Bank A provides 10-year amortizing loans to customers. The entity manages those loans on a collective basis based on similar risk characteristics. The loan portfolio was originated over the last 10 years and has an amortized cost of $3,000,000.

326-20-55-20 After comparing historical information for similar **financial assets** with the current and forecasted direction of the economic cycle, Community Bank A believes that its most recent 10-year period is a reasonable period on which to base its expected credit loss-rate calculation after considering the underwriting standards for loans that existed over the historical period in comparison with the current portfolio. The community bank's cumulative historical lifetime credit loss rate for the most recent 10-year period is 1.5 percent. The historical credit loss rate already factors in prepayment history, which it expects to remain unchanged.

326-20-55-21 In accordance with paragraph 326-20-55-4, Community Bank A considered significant factors that could affect the expected collectibility of the **amortized cost basis** of the portfolio and determined that the primary factors are real estate values and unemployment rates. As part of this analysis, Community Bank A observed that real estate values in the community have decreased and the unemployment rate in the community has increased as of the current reporting period date. Based on current conditions and reasonable and supportable forecasts, Community Bank A expects that there will be an additional decrease in real estate values over the next one to two years, and unemployment rates are expected to increase further over the next one to two years. To adjust the historical loss rate to reflect the effects of those differences in current conditions and forecasted changes, Community Bank A estimates an incremental 10-basis-point increase in credit losses due to the expected decrease in real estate values, and a 5 basis point increase due to expected deterioration in unemployment rates. . Management estimates the incremental fifteen basis-point increase based on its knowledge of historical loss experience during past years in which there were similar trends in real estate values and unemployment rates. Management is unable to support its estimate of expectations for real estate values and unemployment beyond Year 2 of the forecast and decides to immediately revert to the historical credit loss experience after Year 2.

326-20-55-22 The historical loss rate to apply to the amortized cost basis of the loan portfolio would then be adjusted by an incremental 15 basis points to 1.65 percent. The allowance for expected credit losses for the reporting period date would be $49,500.

> > Example 2: Estimating Expected Credit Losses Using a Loss-Rate Approach (Individual Evaluation)

326-20-55-23 This Example illustrates one way an entity may estimate expected credit losses on an individual **loan** using a loss-rate approach when no loans with similar risk characteristics exist.

326-20-55-24 Community Bank B provides residential real estate loans to borrowers in the community. In the current year, Community Bank B started a program to originate commercial loans. Community Bank B has one commercial loan outstanding at period end and because the commercial loan does not share similar risk characteristics, the bank does not believe it is appropriate to pool the commercial loan for purposes of determining its allowance for credit losses. Community Bank B's commercial loan has an amortized cost of $1,000,000. Historical loss information for commercial loans in the community with similar risk characteristics show a 0.50 percent loss rate over the contractual term.

326-20-55-25 Community Bank B considers relevant current conditions and reasonable and supportable forecasts that relate to its lending practices and environment and the specific borrower. Community Bank B determines that the significant factors affecting the performance of this loan are borrower specific operating results and local unemployment rates. Community Bank B considers other qualitative factors including national macroeconomic conditions but determines that they are not significant inputs to the loss estimates for to this loan.

326-20-55-26 Community Bank B is able to reasonably forecast local unemployment rates and borrower specific financial results for one year only. Community Bank B's reasonable and supportable forecasts of those factors indicate that local unemployment rates are expected to remain stable (based on the main employer in the community continuing to operate normally) and there will be a deterioration in the borrower's financial results (based on an evaluation of rent rolls). Management determines that no adjustment is necessary for local unemployment rates because they are expected to be consistent with the conditions in the 0.50 percent loss rate estimate. However, the current and forecasted conditions related to borrower specific financial results are different from the conditions in the 0.50 percent loss rate estimate, based on borrower specific information. Community Bank B determines that an upward adjustment of 10 basis points to the historical loss information is appropriate based on those factors. Management estimates the 10-basis-point adjustment based on its knowledge of commercial loan loss history in the community when borrowers exhibit similar declines in financial performance.

326-20-55-27 The historical loss rate to apply to the **amortized cost basis** of the individual loan would then be adjusted an incremental 10 basis points to 0.60 percent. The allowance for expected credit losses for the reporting period date would be $6,000.

> > Example 3: Estimating Expected Credit Losses on a Vintage-Year Basis

326-20-55-28 The following Example illustrates one way an entity might estimate the expected credit losses on a vintage-year basis.

326-20-55-29 Community Bank C is a lending institution that provides financing to consumers purchasing new or used farm equipment throughout the local area. Community Bank C originates approximately the same amount of loans each year. The four-year amortizing loans it originates are secured by using a relatively consistent range of loan-to-collateral-value ratios at origination. The underlying farm equipment collateral is repossessed and sold at auction by Community Bank C when the borrower becomes 90-days past due.

326-20-55-30 Community Bank C tracks those **loans** on the basis of the calendar-year of origination. The following pattern of credit loss experience has been developed based on the amount of amortized cost in each vintage that was written off as a result of credit losses.

Year of Origination	Loss Experience in Years Following Origination					
	Year 1	Year 2	Year 3	Year 4	Total	Total Expected
20X1	$ 50	$ 120	$ 140	$ 30	$ 340	-
20X2	$ 60	$ 120	$ 160	$ 50	$ 390	-
20X3	$ 40	$ 110	$ 150	$ 30	$ 330	-
20X4	$ 60	$ 110	$ 150	$ 40	$ 360	-
20X5	$ 50	$ 130	$ 170	$ 50	$ 400	-
20X6	$ 70	$ 150	$ 180	$ 60	$ 460	$ 60
20X7	$ 80	$ 140	$ 190	$ 70	$ 480	$ 260
20X8	$ 70	$ 150	$ 200	$ 80	$ 500	$ 430
20X9	$ 70	$ 160	$ 200	$ 80	$ 510	$ 510

326-20-55-31 In estimating expected credit losses on the remaining outstanding loans at December 31, 20X9, Community Bank C considers its historical loss experience. It notes that the majority of losses historically emerge in Year 2 and Year 3 of the loans. It notes that historical loss experience has worsened since 20X3 and that loss experience for loans originated in 20X6 has already equalled the loss experience for loans originated in 20X5 despite the fact that the 20X6 loans will be outstanding for one additional year as compared with those originated in 20X5. In considering current conditions and reasonable and supportable forecasts, Community Bank C notes that there is an oversupply of used farm equipment in the resale market that is expected to continue, thereby putting downward pressure on the resulting collateral value of equipment. It also notes that severe weather in recent years has increased the cost of crop insurance and this trend is expected to continue. On the basis of those factors, the entity determines the remaining expected losses (represented by the shaded cells in the table in paragraph 326-20-55-30 in each respective year), and arrives at expected losses of $60, $260, $430, and $510 for loans originated in 20X6, 20X7, 20X8, and 20X9, respectively.

> > Example 4: Estimating Expected Credit Losses Using Both a Collective Method and an Individual Asset Method

326-20-55-32 This Example illustrates a situation in which loans with credit deterioration are evaluated individually because they no longer exhibit risk characteristics similar to other loans. There is no requirement to evaluate **financial assets** individually when a certain level of credit deterioration has occurred. However, the assessment of whether financial assets exhibit similar risk characteristics should be on the basis of the relevant and appropriate facts and circumstances.

326-20-55-33 An entity may estimate expected credit losses for some financial assets on a collective (pool) basis and may estimate expected credit losses for other assets on an individual basis when similar risk characteristics do not exist. As a result, the method used to estimate expected credit losses for a financial asset may change over time. For example, a pool of homogeneous loans may initially use a loss-rate method, but certain individual loans no longer may have similar risk characteristics because of credit deterioration. When a financial asset no longer shares similar risk characteristics with the original pool of financial assets, an entity should evaluate that financial asset to determine whether it shares risk characteristics similar to other pools of loans. Expected credit losses of that financial asset should be measured individually if there are no similar risk characteristics with other loans. A discounted cash flow approach is one method to estimate expected credit losses of individual loans, but it is not a required methodology. Paragraphs 326-20-55-34 through 55-36 illustrate those concepts.

326-20-55-34 One loan program from Bank D provides unsecured commercial loans of up to $75,000 to small businesses and entrepreneurs. Given the relative homogeneity of the borrowers (in terms of credit risk) and loans (in terms of type, amount, and underwriting standards) in the program, the entity manages this loan program on a collective basis. However, Bank D concludes that the loss estimates for loans with credit deterioration is based on borrower-specific facts and circumstances because the repayment of those loans depends on facts and circumstances unique to each borrower. Therefore, Bank D estimates expected credit losses on an individual basis for loans that no longer exhibit similar risk characteristics because of credit deterioration. A loss-rate method for estimating expected credit losses on a pooled basis is applied for the loans in the **portfolio segment** that continue to exhibit similar risk characteristics.

326-20-55-35 To estimate expected credit losses for individual loans without similar risk characteristics, Bank D uses a discounted cash flow model for each loan. Frequently, Bank D has insight into the likelihood of a credit loss as a result of information provided by the borrower and recent discussions with the borrower given the elevated credit risk for these loans. The allowance for credit losses is estimated as the difference between the **amortized cost basis** and the present value of cash flows expected to be collected.

326-20-55-36 To estimate expected credit losses for the remainder of the loans that continue to exhibit similar risk characteristics, Bank D considers historical loss experience (updated for current conditions and reasonable and supportable forecasts that affect the expected collectibility of the amortized cost basis of the pool) using an average loss-rate approach.

> > Example 5: Estimating Expected Credit Losses for Trade Receivables Using an Aging Schedule

326-20-55-37 This Example illustrates one way an entity may estimate expected credit losses for trade receivables using an aging schedule.

326-20-55-38 Entity E manufactures and sells products to a broad range of customers, primarily retail stores. Customers typically are provided with payment terms of 90 days with a 2 percent discount if payments are received within 60 days. The entity has tracked historical loss experience for its trade receivables and compiled the following historical credit loss percentages:

a. 0.3 percent for receivables that are current
b. 8 percent for receivables that are 1–30 days past due
c. 26 percent for receivables that are 31–60 days past due
d. 58 percent for receivables that are 61–90 days past due
e. 82 percent for receivables that are more than 90-days past due.

326-20-55-39 Entity E believes that this historical loss experience is a reasonable base on which to determine expected credit losses for trade receivables held at the reporting date because the composition of the trade receivables at the reporting date is consistent with that used in developing the historical credit-loss percentages (that is, the similar risk characteristics of its customers and its lending practices has not changed significantly over time). However, Entity E has determined that the current and reasonable and supportable forecasted economic conditions have improved as compared to the economic conditions used to calculate historical statistics. Specifically, Entity E has observed that unemployment has decreased as of the current reporting date, and Entity E expects there will be an additional decrease in unemployment over the next year. To adjust the historical loss rates to reflect the effects of these difference in current conditions and forecasted changes, Entity A estimates the loss rate to decrease by approximately 10 percent in each age bucket.

326-20-55-40 At the reporting date, Entity E develops the following aging schedule to estimate expected credit losses.

Past-Due Status	Amortized Cost Basis	Credit-Loss Rate	Expected Credit-Loss Estimate
Current	$5,984,698	0.27%	$16,159
1–30 days past due	8,272	7.2%	596
31–60 days past due	2,882	23.4%	675
61–90 days past due	842	52.2%	440
More than 90-days past due	1,100	73.8%	812
	$5,997,794		$18,682

> > Example 6: Estimating Expected Credit Losses—Practical Expedient for Collateral-Dependent Financial Assets

326-20-55-41 This Example illustrates one way an entity may implement the guidance in paragraph 326-20-35-4 for estimating expected credit losses on a **collateral-dependent financial asset**.

326-20-55-42 Bank F provides commercial real estate **loans** to developers of luxury apartment buildings. Each loan is secured by a respective luxury apartment building. Over the past two years, housing prices have dropped significantly, while luxury apartment communities have experienced an increase in vacancy rates.

326-20-55-43 At the end of 20X7, Bank F reviews its commercial real estate loan to Developer G and observes that Developer G is experiencing financial difficulty as a result of, among other things, decreasing rental rates and increasing vacancy rates in its apartment building.

326-20-55-44 After analyzing Developer G's financial condition and the operating statements for the apartment building, Bank F believes that Developer G has no other unencumbered assets and will be unable to repay the loan at maturity in 20X9. Therefore, Bank F believes that the loan can be repaid only through the foreclosure and sale (rather than the operation) of the collateral and, accordingly, believes that the loan to Developer G meets the definition of a collateral-dependent loan. As a result, in its financial statements for the period ended December 31, 20X7, Bank F utilizes the practical expedient provided in paragraph 326-20-35-4 and considers the apartment building's **{add glossary link to 2nd definition}fair value{add glossary link to 2nd definition}**, less costs to sell, when developing its estimate of expected credit losses.

> > Example 7: Estimating Expected Credit Losses—Practical Expedient for Financial Assets with Collateral Maintenance Provisions

326-20-55-45 This Example illustrates one way an entity may implement the guidance in paragraph 326-20-35-5 for estimating expected credit losses on **financial assets** with collateral maintenance provisions.

326-20-55-46 Bank H enters into a reverse repurchase arrangement with Entity I that is in need of short-term financing. Under the terms of the arrangement, Entity I sells securities to Bank H with the expectation that it will repurchase those securities for a certain price on an agreed-upon date. In addition, the arrangement contains a provision that requires Entity I to provide security collateral that is valued daily, and the amount of the collateral is adjusted up or down to reflect changes in the **fair value** of the underlying securities transferred. This collateral maintenance provision is designed to ensure that at any point during the arrangement, the fair value of the collateral continually equals or is greater than the **amortized cost basis** of the reverse repurchase arrangement.

326-20-55-47 At the end of the first reporting period after entering into the arrangement with Entity I, Bank H evaluates the reverse repurchase arrangement's collateral maintenance provision to determine whether it can use the practical expedient in accordance with paragraph 326-20-35-5 for estimating expected credit losses. Bank H determines that although there is a risk that Entity I may default, Bank H's expectation of nonpayment of the amortized cost basis on the reverse repurchase agreement is zero because Entity I continually adjusts the amount of collateral such that the fair value of the collateral is always equal to or greater than the amortized cost basis of the reverse repurchase agreement. In addition, Bank H continually monitors that Entity I adheres to the collateral maintenance provision. As a result, Bank H uses the practical expedient in paragraph 326-20-35-5 and does not record expected credit losses at the end of the first reporting period because the fair value of the security collateral is greater than the amortized cost basis of the reverse repurchase agreement. Bank H performs a reassessment of the fair value of collateral in relation to the amortized cost basis each reporting period.

> > Example 8: Estimating Expected Credit Losses on a U.S. Treasury Security when Potential Default Is Greater than Zero, but Expected Nonpayment Is Zero

326-20-55-48 This Example illustrates one way an entity may estimate expected credit losses when the expectation of nonpayment is zero.

326-20-55-49 Entity J invests in U.S. Treasury securities with the intent to hold them to collect contractual cash flows to maturity. As a result, Entity J classifies its U.S. Treasury securities as held-to-maturity and measures the securities on an **amortized cost basis**.

326-20-55-50 Although U.S. Treasury securities often receive the highest credit rating by rating agencies at the end of the reporting period, Entity J's management still believes there is a possibility of default, even if that risk is remote. However, Entity J considers the guidance in paragraph 326-20-30-10 and concludes that the long history with no credit losses for U.S. Treasury securities (adjusted for current conditions and reasonable and supportable forecasts) indicates an expectation that nonpayment of the amortized cost basis is zero, even if the U.S. government were to technically default. Judgment is required to determine the nature, depth, and extent of the analysis required to evaluate the effect of current conditions and reasonable and supportable forecasts on the historical credit loss experience, including qualitative factors. In this circumstance, Entity J notes that U.S. Treasury securities are explicitly fully guaranteed by a sovereign entity that can print its own currency and that the sovereign entity's currency is routinely held by central banks and other major financial institutions, is used in international commerce, and commonly is viewed as a reserve currency, all of which qualitatively indicate that historical credit loss experience should be minimally affected by current conditions and reasonable and supportable forecasts. Therefore, Entity J does not record expected credit losses for its U.S. Treasury securities at the end of the reporting period.

> > Example 9: Recognizing Writeoffs and Recoveries

326-20-55-51 This Example illustrates how an entity may implement the guidance in paragraphs 326-20-35-7 through 35-8 relating to writeoffs and recoveries of expected credit losses on **financial assets**.

326-20-55-52 Bank K currently evaluates its **loan** to Entity L on an individual basis because Entity L is 90-days past due on its loan payments and the loan no longer exhibits similar risk characteristics with other loans in the portfolio. At the end of December 31, 20X3, the **amortized cost basis** for Entity L's loan is $500,000 with an allowance for credit losses of $375,000. During the first quarter of 20X4, Entity L issues a press release stating that it is filing for bankruptcy. Bank K determines that the $500,000 loan made to Entity L is uncollectible. Bank K measures a full credit loss on the loan to Entity L and writes off its entire loan balance in accordance with paragraph 326-20-35-7, as follows.

Credit loss expense	$125,000	
Allowance for credit losses		$125,000
Allowance for credit losses	$500,000	
Loan receivable		$500,000

During March 20X6, Bank K receives a partial payment of $50,000 from Entity L for the loan previously written off. Upon receipt of the payment, Bank K recognizes the recovery in accordance with paragraph 326-20-35-7, as follows.

Cash	$50,000	
Allowance for credit losses		$50,000

326-20-55-53 For its March 31, 20X6 financial statements, Bank K estimates expected credit losses on its financial assets and determines that the current estimate is consistent with the estimate at the end of the previous reporting period. During the period, Bank K does not record any change in amounts to its allowance for credit losses account other than the recovery of the loan to Entity L. To adjust its allowance for credit losses to reflect the current estimate, Bank K reports the following on March 31, 20X6.

Allowance for credit losses	$50,000	
Credit loss expense		$50,000

Alternatively, Bank K could have recorded the recovery of $50,000 directly as a reduction to credit loss expense.

Example 10: Application of Expected Credit Losses to Unconditionally Cancelable Loan Commitments

326-20-55-54 This Example illustrates the application of the guidance in paragraph 326-20-30-11 for off-balance-sheet commitments that are unconditionally cancellable by the issuer.

326-20-55-55 Bank M has a significant credit card portfolio, including funded balances on existing cards and unfunded commitments (available credit) on credit cards. Bank M's card holder agreements stipulate that the available credit may be unconditionally cancelled at any time.

326-20-55-56 When determining the allowance for credit losses, Bank M estimates the expected credit losses over the remaining lives of the funded credit card **loans**. Bank M does not record an allowance for unfunded commitments on the unfunded credit cards because it has the ability to unconditionally cancel the available lines of credit. Even though Bank M has had a past practice of extending credit on credit cards before it has detected a borrower's default event, it does not have a present obligation to extend credit. Therefore, an allowance for unfunded commitments should not be established because credit risk on commitments that are unconditionally cancellable by the issuer are not considered to be a liability.

Example 11: Identifying Purchased Financial Assets with Credit Deterioration

326-20-55-57 This Example illustrates factors that may be considered when assessing whether the purchased **financial assets** have more than an insignificant deterioration in credit quality since origination.

326-20-55-58 Entity N purchases a portfolio of **financial assets** subsequently measured at **amortized cost basis** with varying levels of credit quality. When determining which assets should be considered to be in the scope of the guidance for **purchased financial assets with credit deterioration**, Entity N considers the factors in paragraph 326-20-55-4 that are relevant for determining collectibility.

326-20-55-59 Entity N assesses what is more-than-insignificant credit deterioration since origination and considers the purchased assets with the following characteristics to be consistent with the factors that affect collectibility in paragraph 326-20-55-4. Entity N records the allowance for credit losses in accordance with paragraph 326-20-30-13 for the following assets:

a. Financial assets that are delinquent as of the acquisition date
b. Financial assets that have been downgraded since origination
c. Financial assets that have been placed on nonaccrual status
d. Financial assets for which, after origination, credit spreads have widened beyond the threshold specified in its policy.

326-20-55-60 Judgment is required when determining whether purchased financial assets should be recorded as purchased financial assets with credit deterioration. Entity N's considerations represent only a few of the possible considerations. There may be other acceptable considerations and policies applied by an entity to identify purchased financial assets with credit deterioration.

Example 12: Recognition of Purchased Financial Asset with Credit Deterioration

326-20-55-61 This Example illustrates application of the guidance to an individual **purchased financial asset with credit deterioration**.

326-20-55-62 Under paragraphs 326-20-30-13 and 310-10-35-55, for purchased financial assets with credit deterioration, the discount embedded in the purchase price that is attributable to expected credit losses should not be recognized as interest income and also should not be reported as a credit loss expense upon acquisition.

326-20-55-63 Bank O records purchased financial assets with credit deterioration in its existing systems by recognizing the **amortized cost basis** of the asset, at acquisition, as equal to the sum of the purchase price and the associated allowance for credit loss at the date of acquisition. The difference between amortized cost basis and the par amount of the debt is recognized as a noncredit discount or premium. By doing so, the credit-related discount is not accreted to interest income after the acquisition date.

326-20-55-64 Assume that Bank O pays $750,000 for a **financial asset** with a par amount of $1,000,000. The instrument is measured at amortized cost basis. At the time of purchase, the allowance for credit loss on the unpaid principal balance is estimated to be $175,000. At that date of acquisition, the statement of financial position would reflect an amortized cost basis for the financial asset of $925,000 (that is, the amount paid plus the allowance for credit loss) and an associated allowance for credit losses of $175,000. The difference between par of $1,000,000 and the amortized cost of $925,000 is a non-credit related discount. The acquisition-date journal entry is as follows.

Loan—par amount	$1,000,000	
Loan—noncredit discount		$ 75,000
Allowance for credit losses		175,000
Cash		750,000

326-20-55-65 Subsequently, the $75,000 noncredit discount would be accreted into interest income over the life of the financial asset consistent with other Topics. The $175,000 allowance for credit losses should be updated in subsequent periods consistent with the guidance in Section 326-20-35 on subsequent measurement of financial instruments measured at amortized cost, with changes in the allowance for credit losses on the unpaid principal balance reported immediately in the statement of financial performance as a credit loss expense.

Example 13: Determining the Loss-Rate Approach for Determining Expected Credit Losses and the Effective Interest Rate on a Purchased Financial Asset with Credit Deterioration

326-20-55-66 This Example illustrates the application of the guidance to determine the expected credit loss using an average loss rate for an individual **purchased financial asset with credit deterioration**.

326-20-55-67 Bank P purchases a $5,000,000 amortizing nonprepayable **loan** with a 6 percent coupon rate and original contract term of 5 years. All contractual principal and interest payments due of $1,186,982 for each of the first 3 years of the loan's life have been received, and the loan has an unpaid balance of $2,176,204 at the purchase date at the beginning of Year 4 of the loan's life. The original contractual amortization schedule of the loan is as follows.

Original Amortization Table

Period	Beginning Balance	Total Payment	Interest	Principal	Ending Balance
1	$5,000,000	$1,186,982	$300,000	$886,982	$4,113,018
2	4,113,018	1,186,982	246,781	940,201	3,172,817
3	3,172,817	1,186,982	190,369	996,613	2,176,204
4	2,176,204	1,186,982	130,572	1,056,410	1,119,794
5	1,119,794	1,186,982	67,188	1,119,794	-
Totals		**$5,934,910**	**$934,910**	**$5,000,000**	

326-20-55-68 At the purchase date, the loan is purchased for $1,918,559 because significant credit events have been discovered. The purchaser expects a 10 percent loss rate, based on historical loss experience, adjusted for current conditions and reasonable and supportable forecasts, for groups of similar loans. In accordance with paragraph 326-20-30-14, as a result of the expected credit losses, the allowance is estimated as $217,620 by multiplying the 10 percent loss rate to the unpaid principal balance, or par amount, of the loan (see beginning balance in Year 4 in the table above). The following journal entry is recorded at the acquisition of the loan.

Loan	2,176,204	
Loan—noncredit discount		40,025
Allowance for credit losses		217,620
Cash		1,918,559

326-20-55-69 The contractual interest rate is adjusted for the noncredit discount of $40,025 to determine the **effective interest rate** of 7.33 percent, which excludes the purchaser's assessment of expected credit losses at the acquisition date. The 7.33 percent (rounded from 7.3344 percent) is computed as the rate that equates the amortized cost of $2,136,179 (computed by summing the purchase price of $1,918,559 with the gross-up adjustment of $217,620) with the net present value of the remaining contractual cash flows on the purchased asset ($1,186,982 in each of Years 4 and 5).

326-20-55-70 A default occurs in the last year of the loan's life. The amortization of the purchased loan would be recorded as follows for the periods after the purchase date in Years 4 and 5 of the loan's life.

Book Amortization

Period	Beginning Balance [(a)]	Total Payment [(b)]	Writeoff [(c)]	Interest [(d)]	Principal [(e)]	Ending Balance [(f)]
4	$2,136,179	$1,186,982		$156,676	$1,030,306	$1,105,873
5	1,105,873	969,362	217,620	81,109	1,105,873	0
Totals		**$2,156,344**	**$217,620**	**$237,785**	**$2,136,179**	

(a) The amortized cost at the purchase date is determined as the sum of the purchase price of $1,918,559 and the allowance for credit losses of $217,620.

(b) The cash received is consistent with the expectations at the purchase date.

(c) The writeoff represents the default in the final year of the loan that is written off.

(d) The interest income recognized is determined by multiplying the beginning amortized cost by the effective interest rate of 7.33 percent (as determined in accordance with paragraph 326-20-55-66).

(e) The reduction of amortized cost is determined as the sum of the cash received (b) and writeoffs recognized (c) (if any), less the interest income recognized (d). The writeoff in Year 5 represents the difference between the contractual cash flows of $1,186,982 and the actual cash flows of $969,362.

(f) The ending amortized cost is equal to the beginning amortized cost (a), less the amortized cost reduction (e).

326-20-55-71 The rollforward of the allowance would be as follows.

Beginning allowance for credit losses	$ 217,620
Plus, credit loss expense	-
Less, writeoffs	(217,620)
Ending allowance for credit losses	$ -

Example 14: Determining the Discounted Cash Flow Approach for Determining Expected Credit Losses and the Effective Interest Rate on a Purchased Financial Asset with Credit Deterioration

326-20-55-72 This Example illustrates the application of the guidance to determine the expected credit loss using a discounted cash flow approach for an individual **purchased financial asset with credit deterioration**.

326-20-55-73 This Example uses the same assumptions as Example 13, as described in paragraphs 326-20-55-66 through 55-71.

326-20-55-74 To determine the **effective interest rate** in accordance with paragraph 326-20-30-14, the expected cash flows would be estimated and discounted at a rate that equates the purchase price with the present value of expected cash flows. The expected cash flows, including the considerations for current conditions and reasonable and supportable forecasts are expected to be $1,186,982 in Year 4 and $969,362 in Year 5. The discount rate that equates the purchase price with the cash flows expected to be collected is 8.46 percent (rounded from 8.455 percent). This also is the same rate that equates the **amortized cost basis** (purchase price plus the acquisition date allowance for credit losses) with the net present value of the future contractual cash flows.

326-20-55-75 To determine the allowance for credit losses at the purchase date, the expected credit loss (that is, the contractual cash that an entity does not expect to collect) is discounted using the effective interest rate or 8.46 percent. The expected credit loss is $217,620 in Year 5, as determined by finding the difference between the contractual cash flows of $1,186,982 and the expected cash flows of $969,362. The present value of the expected loss at the purchase date is $185,012. The journal entry to record the purchase of this loan is as follows:

Loan	2,176,204	
Loan—noncredit discount		72,633
Allowance for credit losses		185,012
Cash		1,918,559

326-20-55-76 The amortization of the loan in the years following the purchase date is as follows.

Book Amortization

Period	Beginning Balance [(a)]	Total Payment [(b)]	Writeoff [(c)]	Interest [(d)]	Principal [(e)]	Ending Balance [(f)]
4	$ 2,103,571	$ 1,186,982		$ 177,857	$ 1,009,125	$ 1,094,446
5	1,094,446	969,362	217,620	92,536	1,094,446	0
Totals		**$ 2,156,344**	**$ 217,620**	**$ 270,393**	**$ 2,103,571**	

(a) The amortized cost at the purchase date is determined as the sum of the purchase price of $1,918,559 and the allowance for credit losses of $185,012.

(b) The cash received is consistent with the expectations at the purchase date.

(c) The writeoff represents the default in the final year of the loan that is written off.

(d) The interest income recognized is determined by multiplying the beginning amortized cost by the effective interest rate of 8.46 percent (as determined in accordance with paragraph 326-20-55-74).

(e) The reduction of amortized cost is determined as the sum of the cash received (b) and writeoffs recognized (c) (if any), less the interest income recognized (d). The writeoff in Year 5 represents the difference between the contractual cash flows of $1,186,982 and the actual cash flows of $969,362.

(f) The ending amortized cost is equal to the beginning amortized cost [A], less the amortized cost reduction [e].

326-20-55-77 The Day-1 allowance established at the purchase date was $185,012. The allowance for credit losses was estimated on a discounted cash flow approach and, therefore, the allowance for credit losses needs to be adjusted for the time value of money. The rollforward of the allowance for credit losses is shown below.

Beginning allowance for credit losses	$ 185,012	
Plus, credit loss expense	15,643	(a)
Less, writeoffs	-	
Ending allowance for credit losses (Year 4)	200,655	
Plus, credit loss expense	16,965	(a)
Less, writeoffs	(217,620)	(b)
Ending allowance for credit losses (Yearr 5)	$ -	

(a) The provision for credit losses in Year 4 and Year 5 is determined by multiplying the beginning allowance for credit losses by the effective interest rate of 8.46 percent to adjust for the time value of money.

(b) The writeoff represents the default in Year 5. The default is the difference between the Year 5 contractual cash flows of $1,186,982 and the actual cash flows received of $969,362.

326-20-55-78 The net income effect of a loss-rate approach illustrated in Example 13 and for a discounted cash flow approach illustrated in this Example is the same ($237,785 net income). The difference between the two approaches is that the Day-1 allowance for credit losses under a discounted cash flow approach explicitly reflects the time value of money. Therefore, it needs to be accreted to the future value of the loss that ultimately will occur. The change in the allowance for credit losses because of the time value of money can be presented either as credit loss expense or as an adjustment to interest income in accordance with paragraph 326-20-45-3. Therefore, the discounted cash flow approach, over the life of the asset, presents interest income as $270,393 but will require $32,608 ($15,643 in Year 4 plus $16,965 in Year 5) of credit loss expense to be recorded for the time value of money, resulting in net interest income after credit loss expense of $237,785. Under a loss-rate approach as illustrated in Example 13, interest income over the life of the asset is $237,785 but does not require credit loss expense to be recognized.

Example 15: Disclosing Credit Quality Disclosures of Financing Receivables

326-20-55-79 The following Example illustrates the presentation of credit quality disclosures for a financial institution with a narrow range of **loan** products offered to local customers—both consumer and commercial. An entity may choose other methods of determining the **class of financing receivable** and may determine different **credit quality indicators** that reflect how credit risk is monitored. Some entities may have more than one credit quality indicator for certain classes of financing receivables.

	Origination Year						
As of or for the year ended December 31, 2015	2014	2013	2012	2011	2010 and prior	Revolving Loans	Total
Residential Mortgage:							
Current estimated Loan to Value ratios							
Greater than 125% and updated FICO scores							
Equal or greater than 660	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Less than 660	-	-	-	-	-	-	-
101% to 125% and updated FICO scores							
Equal or greater than 660	-	-	-	-	-	-	-
Less than 660	-	-	-	-	-	-	-
80% to 100% and updated FICO scores							
Equal or greater than 660	-	-	-	-	-	-	-
Less than 660	-	-	-	-	-	-	-
Less than 80% and updated FICO scores							
Equal or greater than 660	-	-	-	-	-	-	-
Less than 660	-	-	-	-	-	-	-
U.S. government guaranteed	-	-	-	-	-	-	-
Total residential mortgage loans	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Residential Mortgage loans:							
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Consumer:							
By updated FICO							
<600	$ -	$ -	$ -	$ -	$ -	$ -	$ -
600-639	-	-	-	-	-	-	-
640-679	-	-	-	-	-	-	-
680-719	-	-	-	-	-	-	-
720-759	-	-	-	-	-	-	-
760-799	-	-	-	-	-	-	-
800+	-	-	-	-	-	-	-
Total consumer	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Consumer loans:							
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Business:							
Risk rating:							
1 - 2 internal grade	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3 - 4 internal grade	-	-	-	-	-	-	-
5 internal grade	-	-	-	-	-	-	-
6 internal grade	-	-	-	-	-	-	-
7 internal grade	-	-	-	-	-	-	-
Total commercial business	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Business Loans:							
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Mortgage:							
Risk Rating:							
1 - 2 internal grade	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3 - 4 internal grade	-	-	-	-	-	-	-
5 internal grade	-	-	-	-	-	-	-
6 internal grade	-	-	-	-	-	-	-
7 internal grade	-	-	-	-	-	-	-
Total commercial mortgage	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Mortgage Loans:							
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -

>>Example 16: Disclosing Past-Due Status

326-20-55-80 The following table illustrates certain of the disclosures in paragraph 326-20-50-14 by class of financing receivable.

Age Analysis of Past-Due Financial Assets
As of December 31, 20X1, and 20X0

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total	Amortized Cost >90 Days and Accruing
20X1							
Commercial	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Commercial real estate:							
Commercial real estate construction	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commercial real estate—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer:							
Consumer—credit card	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—auto	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential:							
Residential—prime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential—subprime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Finance leases							
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
20X0							
Commercial	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Commercial real estate:							
Commercial real estate construction	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commercial real estate—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer:							
Consumer—credit card	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—auto	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential:							
Residential—prime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential—subprime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Finance leases							
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX

>>Example 17: Identifying Similar Risk Characteristics in Reinsurance Receivables

326-20-55-81 Reinsurance receivables may comprise a variety of risks that affect collectibility including

a. Credit risk of the reinsurer/assuming company
b. Contractual coverage disputes between the reinsurer/assuming company and the insurer/ceding company including contract administration issues, and
c. Other noncontractual, noncoverage issues including reinsurance billing and allocation issues.

326-20-55-82 In situations in which similar risk characteristics are not present in the **reinsurance receivables**, the ceding insurer should measure expected credit losses on an individual basis.

326-20-55-83 Similar risk characteristics may not exist because any one or a combination of the following factors exist (including, but not limited to): customized reinsurance agreements associated with individual risk geographies, different size and financial conditions of reinsurers that may be either domestic or international, different attachment points among reinsurance agreements, different collateral terms of the reinsurance agreements (such as collateral trusts or letters of credit), and the existence of state-sponsored reinsurance programs.

326-20-55-84 However, similar risk characteristics may exist for those reinsurance receivables because any one or combination of the following exist: reinsurance agreements that have standardized terms, involve similar insured risks and underwriting practices, and the reinsurance counterparties have similar financial characteristics and face similar economic conditions.

326-20-55-85 Judgment should be applied by ceding insurers for when similar risks exists within their reinsurance receivables.